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RUEHIL/AMEMBASSY ISLAMABAD 6916
RUEHKT/AMEMBASSY KATHMANDU 4991
RUEHGP/AMEMBASSY SINGAPORE 5670
RUEHBK/AMEMBASSY BANGKOK 3155
RUEHKP/AMCONSUL KARACHI 2157
RUEHCG/AMCONSUL CHENNAI 7489
RUEHGV/USMISSION GENEVA 1872
RUEHC/DEPT OF LABOR WASHDC
RUEATRS/DEPT OF TREASURY WASHDC
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SUBJECT: SRI LANKA: ALLEGATIONS OF IMPROPRIETY IN CONNECTION WITH
NEW STATE-OWNED BUDGET AIRLINE
REF: A) COLOMBO 263 B) COLOMBO 324

¶1. (SBU) SUMMARY AND COMMENT: The Government of Sri Lanka plans to launch in March 2007 a state-run airline aimed at providing low-cost travel for migrant workers and tourists to the Middle East and India. The budget carrier, called Mihin Lanka, has elicited criticism from politicians, the press, and the airline industry. The recently sacked Minister of Ports and Aviation has charged the President with circumventing procedural and financial regulations in the process of creating the airline. Public criticism may have caused the President to back away from allegedly planning to deal free shares in the venture to himself and close family members and political allies. Even so, the venture hardly appears to be in the public interest: First, the plan to use civil service pension funds to start the new venture is risky, as the South Asia region's budget airline market is competitive and the GSL has a poor track record in running airlines. Second, if the venture succeeds in building market share, it will come at the expense of Sri Lankan Airlines, which is still 51 percent government-owned. End summary and comment.

CONTROVERSIAL BUDGET AIRLINE TO BE STATE-OWNED, NAMED FOR PRESIDENT, RUN BY FAMILY AND FRIENDS

¶2. (U) The Government of Sri Lanka (GSL) is planning to launch a state-run airline aimed at providing low-cost travel for Sri Lankan migrant workers and tourists to the Middle East and India. The budget carrier, apparently conceived and advanced by close advisors to Sri Lankan President Mahinda Rajapaksa, is to be called Mihin Lanka, after the President (short for Mihindu, which is the Pali name for Mahinda). The non-transparent way in which the President's coterie has advanced the airline has elicited extensive controversy.

¶3. (U) GSL officials say Mihin Lanka will begin operations this month. (Mihin Lanka offices at the airport and Colombo are now open, but a targeted launch of February 4, Sri Lanka's Independence Day, came and went with no official explanation of the postponement.) On March 5, the airline secured a provisional license to fly after overcoming technical problems that temporarily delayed its maiden test flight. Its initial flight from Colombo Bandaranaike International Airport to India was a requirement for the airline to get an "air operating certificate" from Sri Lanka's Civil Aviation Authority (CAA). The certificate gives Mihin Lanka clearance to operate and handle all aspects of a commercial flight using a leased Fokker-27 aircraft. At this time, the airline does

not own any aircraft.

¶4. (U) The GSL is billing Mihin Lanka as the country's only national airline. (Note: This is odd, because the government still has a 51 percent majority Sri Lankan Airlines; Emirates Airlines owns 43 percent, and the remaining six percent is owned by Sri Lankan Airlines employees). This no-frills carrier is designed to cater to local migrant workers traveling to the Middle East, and to tourists to and from the Indian sub-continent. The government says Mihin Lanka will also function as a cargo airline, transporting goods produced by small and medium scale producers. The venture plans to directly or indirectly create 500 jobs, including positions for Sri Lankan Air Force personnel who want to move into civil aviation.

¶5. (U) The airline is to be a fully government-owned company utilizing state funds. The initial capital contribution is estimated at around 500 million Sri Lankan Rupees (approximately USD 4.6 million), with an estimated total cost set at Rs. 1.5 billion (approx USD 13.8 million). The government initially intended to tap the state-run Foreign Employment Bureau and the Employees' Trust Fund for start up capital in the venture. After a strong public backlash supported by negative media reporting against using public funds, the government may be seeking financial backing elsewhere, but has not publicly identified possible alternate sources.

¶6. (SBU) Critics argue that the carrier's lack of transparency stems from its leadership - a handful of politicians and advisors close to the President. According to a Civil Aviation Authority gazette, the Board of Directors of Mihin Lanka will be composed of Defense Secretary Gothabaya Rajapaksa (the President's brother), Finance

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Secretary P.B. Jayasundera, Air Marshall Roshan Goonetilleke, and

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Presidential Coordinating Secretary Sajin de Vass Gunawardena. Gunawardena, who has been appointed "Accountable Manager in charge" of the airline, has been linked to a number of past allegations of financial impropriety involving government procurement.

AVIATION MINISTER'S OPPOSITION COSTS HIM HIS JOB

¶7. (U) On February 9, President Rajapaksa sacked Minister of Ports

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and Aviation Mangala Samaraweera, who had opposed the Mihin Lanka arrangement (ref A). Rajapaksa did not appoint a replacement for Samaraweera, instead keeping the Ports and Aviation portfolio for himself. On February 17, Samaraweera, who had also served as Rajapaksa's Minister of Foreign Affairs until he was removed in the January 28 cabinet reshuffle, sent a letter to the President listing a series of grievances (ref B). In this, Samaraweera stated his strong disapproval of the Mihin Lanka project due to the planned use

of public funds and the rushed approval process that circumvented normal administrative and financial regulations.

LAUNDRY LIST OF IRREGULARITIES SUGGESTS IMPROPRIETY

¶8. (SBU) Since its conception, Mihin Lanka has appeared to evade a number of Sri Lanka's standard business start-up regulations, many of which former minister Samaraweera outlined in his public letter:

- The President's October 2006 budget proposal for FY 2007 did not mention Mihin Lanka despite plans to use public money to capitalize it.

- Presidential advisors submitted a memorandum to the Cabinet for endorsement of the airline only hours before the cabinet meeting at which they sought approval of the venture.

- No capital appraisal report was conducted on the venture.

- The Board of Investment (BOI) allegedly approved the airline proposal in less than 24 hours.

- The Civil Aviation Authority had already short-listed three budget airline operations prior to Mihin Lanka, but put further processing of their license applications on hold until after Mihin Lanka launches.

DUBIOUS BUSINESS MODEL: STEAL THE OTHER GSL AIRLINE'S CUSTOMERS

¶9. (SBU) Aviation industry insiders told Econoff that if Mihin Lanka succeeds, it would only be by cannibalizing passengers from Sri Lankan Airlines' most profitable routes - those to India and the Middle East. They add that the government's plan to launch the airline by wet-leasing a single plane makes little economic sense, as the high cost of a crew- and maintenance-included wet lease is unlikely to be covered by ticket sales in the low-cost travel sector. Finally, the local aviation market is skeptical of Mihin Lanka's prospects simply because the GSL had such a poor track record for many years running Sri Lankan Airlines, before bringing in Emirates Airlines as an operating partner.

¶10. (SBU) Comment: Civil Aviation Authority officials and representatives of Airport and Aviation Services Ltd. appear less than enthusiastic about the Mihin Lanka venture. In fielding Post's queries, they seemed cautious and uncomfortable, repeatedly stating that they were not aware of many key operational details. Post also notes that local media coverage of the Mihin venture no longer

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mentions any of the earlier controversy around the airline. In fact, coverage disappeared entirely for about two months, and only resumed this week with brief and uncritical coverage of the test flight described in para 3. Many Sri Lankans view the Mihin Lanka venture as a sign that the populist and socialist President Rajapaksa may be tempted to practice crony capitalism if he can avoid press, opposition, and regulatory scrutiny.

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